

ICPS newsletter

ICPS improves its economic forecast

A new issue of ICPS's Quarterly Prediction journal will be published this week. In this issue we have improved our economic forecast significantly: GDP will grow by 5% in 2000 and by 4.5% in 2001 and 2002, prompted by increased domestic demand and productivity. The major risk to our forecast is weak government capacity to make consistent policy and defend it in front of the opposition and the public

In Q3'00, economic growth continued accelerating. Real GDP increased by 5% y-o-y (in Q2'00, this indicator totalled 4.5%).

Value added increased in all sectors of the economy, without exception. The highest growth rate was observed in industry, and the lowest in construction. Agricultural output growth resulted from unexpectedly high yields of vegetables, oilseeds, corn, and sugar beets.

According to our forecast, GDP in 2000 will increase by 5%. Meanwhile, industrial growth will total 10% and agricultural output will decrease by 0.5%, due to the decline in grain crops and livestock.

We explain the outstanding revival of business activity in 2000 by the following reasons:

- expansion in domestic demand. As a result of increased real wages, small business development, and repayment of budget debts on social welfare, household incomes grew by 11.8% during the first 9 months of 2000;
- increase in investment resources at enterprises as a result of stable tax and budget policy. Firstly, the tax burden has decreased in 2000 thanks to cancellation of the "highway levy," the reduction of the number of excisable commodities, and progress in VAT refunds from the budget. Secondly, this year's strict budget policy (compared to last year's) enabled a decrease in loan interest rates;
- financial stability. The exchange rate was predictable, while monetary policy was more consistent, and monetary expansion had a stimulating effect;
- favourable conditions in foreign markets. Despite the increase in world oil prices, the global economy continued to grow.

Thanks to influence of these factors, enterprises have been adapting to market conditions more easily. Reacting to increased demand, managers of enterprises invested in new equipment and hired more skilled employees.

We forecast that the economic growth factors will persist in 2001–2002. External market conditions will deteriorate slightly, but will still be favourable. At the same time, domestic demand will grow, both on the part of households

Changes in economic outlook for 2001–2002

Variable	Revised forecast
GDP	Will increase faster, because of high domestic and stable external demand, and thanks to productivity growth
Private consumption	Will grow faster, thanks to increased income from entrepreneurial activity and improved expectations
Public consumption	Will increase in 2000 as a result of budget revenue growth; forecast for 2001–2002 remains unchanged
Investment	Will increase faster, due to higher profits and higher volume of FDI in 2001–2002
Export	The forecast for 2000–2001 is adjusted upward, since foreign markets will continue to be favourable. No change for the 2002 forecast
Import	Will increase faster in 2000–2001, because of increased growth in domestic demand. No change for the 2002 forecast
Inflation	Will be higher, as a result of sluggish expectations and demand pressure
Exchange rate	The rate will drop, since foreign currency inflow will increase
Unemployment	Slightly increased, as a result of higher mobility of employees
GDP of trading partners	The forecast is adjusted upward, mainly because of accelerated growth in the Russian economy

Changes in policy outlook for 2001–2002

Variable	Forecast
Political stability	Agreement on the 2001 budget will be evidence of a framework consensus regarding reforms reached by all arms of government. Opposition criticism will increase as the 2002 parliamentary elections approach. The poor ability of the government to deal with this criticism can pose a risk to political stability
Consistency of legislative framework	Civil and Customs Codes will be adopted in 2001. Uncertainty will persist until the Tax and Land Codes are passed in 2002
Business development	More consistent regulations will foster adaptation of economic entities to market conditions. However, new government capacity to develop "rules of the game" will not advance quickly
Privatisation	For the first time, the government will privatise natural monopolies. Electricity distributing companies will be sold in 2001, and Ukrtelekom in 2002. Preparations will start for transferring gas-transport pipelines to investor
Integration in the world economy	The government will gradually reduce protectionist measures while preparing the country to join the WTO

and on the part of businesses. The tax burden will decrease and budget policy will remain strict. The growth of domestic demand will result in increased imports. GDP will increase by 4.5% and by additional 4.5% in 2002.

In our forecast, we pay special attention to the growth of productivity. The high level of domestic demand, along with long-term growth, will result from improved ability of the economy to produce goods and services in a more efficient way.

In our opinion, the trend of continued productivity growth began in Q4'99. Since that time, GDP in Ukraine has been growing faster than the number of hours worked at enterprises. The efficiency of the economy has increased, thanks to improvements in management and new owners, as well as investment growth.

Government policy will be an important factor for the further growth of productivity. Firstly, in pursuing a strict budget policy and gradually decreasing the tax burden, the government will prompt further investment growth. Secondly, by introducing WTO and EU standards, Ukraine will spur domestic competition, as well as shape Ukraine's competitive advantage necessary for successful integration into the world economy. In this situation, productivity growth will be the most effective way to ensure the competitiveness of Ukrainian enterprises.

In 2001–2002, effective privatisation of natural monopolies will be a criterion for evaluating the success of economic policy. Natural monopolies belong to the infrastructure sector and their development, therefore, will determine the sustainability of economic growth. Ukraine will fully benefit from privatisation of natural monopolies only if effective regulations protecting public interests and stimulating efficient use of resources are introduced in these sectors.

The major risk to our forecast is the government poor capacity to develop consistent policy and defend its policy in front of the opposition and the public. The threat of this risk will be increasing as the 2002 parliamentary elections approach. The lack of government capacity to deal with these problems can increase uncertainty in the business environment. This uncertainty, in turn, will restrain consumption and investment. Furthermore, Ukraine will continue to lose the confidence of international investors and will not be able to combat deteriorated conditions in the international market. ■

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Major indicators

	1999	2000	2001	2002
		(forecast)	(forecast)	(forecast)
Economic activity				
GDP, millions UAH	127,126	168,300	206,400	247,700
Real GDP, apc*	-0.4	5.0	4.5	4.5
Real industrial production, apc	4.3	10.0	8.5	7.0
Real agricultural output, apc	-5.7	-0.5	5.0	6.5
Gross investment, % of GDP	19.8	18.6	19.1	19.9
Direct investments, millions USD (1)	489	700	1,200	1,300
Real household disposable income, apc	1.2	6.0	6.5	7.0
Real retail turnover, apc	-4.8	6.0	5.0	6.0
Prices				
Consumer price index, apc	19	28	18	13
Producer price index, apc	16	20	15	12
Labour market				
Population, millions	49.7	49.4	49.1	48.9
Real wage, average apc	-5.7	1.0	2.5	3.0
Official unemployment rate, %	4.3	5.5	6.0	8.0
Foreign economic activity				
Exports of goods&services, apc	-7.9	7.6	3.7	3.2
Imports of goods&services, apc	-19.1	7.2	4.8	5.3
Current account balance, % of GDP	2.7	2.7	2.5	0.9
Budget				
Revenues (consolidated), % of GDP	25.9	27.5	26.0	25.5
Current balance, % of GDP	-1.5	0.4	0.6	-0.5
Primary balance, % of GDP (2)	0.9	2.9	3.6	2.5
Monetary indicators				
Monetary base, apc	39	28	22	16
M3, apc	41	34	24	18
NBU international reserves, millions USD	1,094	1,050	1,490	1,780
Official exchange rate average annual, UAH/USD	4.13	5.50	6.38	7.00
Interest rate on loans, average annual, yearly % (3)	53	42	36	30
International				
World GDP, apc	3.3	4.5	4.2	3.9
GDP of Ukraine's major trading partners (2/3 of exports) apc	3.0	4.7	4.1	3.8

* apc = annual percentage rate

Notes:

(1) according to NBU

(2) current balance plus state debt servicing

(3) commercial banks loans, hryvnias

Sources: State Statistics Committee, NBU, and Finance Ministry.

Calculations and forecast by Quarterly Predictions.